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African farmers' market organizations and global value chains: competitiveness versus inclusiveness

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ABSTRACT

This conceptual paper discusses the challenges smallholder producer cooperatives in developing countries face while trying to access agricultural global value chains. We assess the problem of competitiveness related to lack of commitment and improper selection. Prioritization of open membership over selection is generally taken for granted in the policy debate on farmers' market organizations (FMOs). We argue that open membership may work in community-driven organizations, however, it becomes a major threat for entrepreneurial FMOs. Inclusion facilitates free riding, which forms a barrier for investments of members. This is one of the major reasons why so many of these organizations are so much resource constrained, i.e. are not able to compete in the market without external support. FMOs should take targeting and selection serious if entrepreneurial activities are intended. Otherwise, they miss the opportunity to create a committed member base willing to invest in a potentially competitive organization.

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1. Introduction

In the development literature, participation of smallholders in global value chains (GVCs) is seen as a promising instrument to realize income opportunities for the rural poor in developing countries (Donovan and Poole 2014; Francesconi and Heerink 2010; Fischer and Qaim 2011; Markelova et al. 2009; World Bank 2007). Some stress a major role for multinationals in the developed countries and advocate investments from their side as part of their corporate social responsibility

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(Karnani 2007). Fair trade chains are another offspring of this discussion (Van Rijsbergen et al. 2016). Although this helps, we have to acknowledge that the market share of fair trade or 'certified' products that result from these initiatives is small and that there are concerns about the sustainability of fair trade (World Bank 2007: 133). Consequently, most smallholders compete in open markets and get paid on the basis of their competitiveness (Bruton et al. 2013).

In a recent overview article on African agriculture, Collier and Dercon (2014) stress the importance of change and a more open-minded approach to different modes of production as African agriculture has to change beyond recognition. They reject the unbalanced preference in policy-making for smallholder support and stress that new institutional and policy frameworks are required. Successful transitions require a recognition that smallholders are heterogeneous and that there is scope for large-scale farmers often in interaction with smaller scale farmers using institutional frameworks that encourage vertical integration and scale economies in processing and marketing. In a similar vein, McMullen (2010) stresses the need for institutional entrepreneurship and proposes a new theory of 'Development Entrepreneurship.'

In line with this literature, we would like to highlight farmers' market organizations (FMOs) as an organizational option for smallholders to improve their competitiveness. FMOs are cooperative organizations that support the income generating activities of their members and differ from cooperative community organizations that only provide club goods or local public goods (Bernard et al. 2008). In Section 3, we discuss these differences further. However, the debate on the role of FMOs is primarily focused on inclusion and upgrading (Gibbon et al. 2008; Humphrey and Schmitz 2002) and impact measurement (Fischer and Qaim 2011; Van Rijsbergen et al. 2016). The contribution of this paper to this literature is to show that a crucial aspect is missing, viz. a strategic assessment of the organization and how it can improve the competitiveness of the involved smallholders. We argue that the focus on inclusion and ignorance of strategic requirements may become a serious threat to more entrepreneurial organizations that have to invest in resources to create a competitive position in the market. In this paper, we show that a strategic management approach complements the existing debate on FMOs in GVCs and helps to identify how smallholder organizations may deliver a major contribution to address the challenges farmers are facing and to create opportunities for their members.

According to strategic management literature profitability along the value chain flows to those companies that are best insulated from profit destroying competitive forces (Barney 1991; Teece et al. 1997). This insight is relevant for smallholders targeting GVCs and improves our understanding why many of them fail to generate a decent income. Smallholders are required to have strategic resources at their disposal in order to be able to appropriate a fair share of the value created (Barney 1991). We criticize extant GVC literature as the creation of strategic resources is not properly addressed. Upgrading and value

creation (qualifying criteria) are discussed but the issue of value appropriation is generally neglected (Gereffi et al. 2005; Kaplinsky 2000).

Acknowledging that smallholders are severely resource-constrained, FMOs may play a crucial role in the creation of strategic resources and competencies (Devaux et al. 2009; Francesconi and Heerink 2010; Fischer and Qaim 2011; Markelova et al. 2009; Poulton et al. 2010). In the small business and entrepreneurship literature, the use of collective economies to create a competitive advantage are well known and discussed as the exploitation of 'external economies of scale' and Malthusian 'agglomeration effects' (Oughton and Whittam 1997; Schmitz 1999). Similarly, FMOs should develop strategic resources to participate successfully in GVCs. In existing literature on African FMOs, the importance of the creation of strategic resources through FMOs is rather neglected and, although impact analysis of FMO membership is studied, the analysis of deficient member commitment is generally absent (Barham and Chitemi 2009; Tefera et al. forthcoming). Fischer and Qaim (2011) concluded that there is a need to better understand under what conditions and for whom collective action is useful and through what mechanisms the potential benefits emerge. We try to address part of this challenge.

The aim of this article is to derive a set of key criteria for success from the strategic management and collective action literature. We apply these insights to the Ethiopian context to exemplify why it is so difficult to create competitive FMOs. Ethiopia is taken as an example because of the long history of the cooperative movement in this country (Tefera et al. forthcoming) and the large number of FMOs active at present (Bernard et al. 2010; Francesconi and Heerink 2010).

Based on our conceptual and empirical analyses, we argue that many African FMOs fail to fulfill the success conditions regarding *commitment, targeting, well-defined property rights and selection*. The creation of strategic resources generally requires investments by committed members. Commitment that is expressed through a willingness to sell through the FMO (Mujawamariya et al. 2013; Wollni and Fischer 2015), a willingness to invest financial resources in the FMO (Sykuta and Cook 2001) and a willingness to participate in the management of the FMO (Barham and Chitemi 2009; Bernard et al. 2010). Crucial conditions for this are clearly specified targets for the FMO (targeted market opportunities), proper selection of members and well-defined property rights for those who invest (Markelova et al. 2009). While targeting helps to focus on specific needs/priorities (Francesconi and Heerink 2010), well-defined property rights and proper selection help to improve efficiency and mitigate free-riding problems.

We also argue that many FMOs operate as if they are community-oriented cooperatives that provide public services to the villagers and prefer to avoid necessary choices in the equity/efficiency dilemma. In line with this extant, FMO literature focuses on inclusion (service delivery) and ignores the creation of a competitive advantage (Markelova et al. 2009). However, this is not always without a cost and even explains why so few FMOs develop into entrepreneurial

organizations (Bernard et al. 2008, 2010). These cooperatives may be successful if major market deficiencies or even missing markets are addressed (World Bank 2007). Yet, in most countries private traders are effective, making it more challenging for cooperatives to create a competitive advantage (Minten et al. 2016; Sitko and Jayne 2013; Tefera et al. forthcoming).

In most market environments, FMOs compete with private traders and, therefore, have to be entrepreneurial. New business models and new business relationships have to be developed (Collier and Dercon 2014; Minten et al. 2016; Sykuta and Cook 2001). We argue that more substantial investments and stronger commitment of members is needed to make this a success. Experiences in developed countries show that there is room for cooperatives in these markets (Cook and Iliopoulos 2000). Thus, we conclude that collective action can be a useful strategy to create access to strategic resources for members of entrepreneurial cooperatives, but only if a committed member base exists, which in turn requires proper targeting, appropriate selection mechanisms to screen members and well-defined property rights to avoid free riding threats.

The article is structured as follows. First, we discuss the role of cooperatives in the agricultural sector and the importance of cooperative economies of scale and clustering (agglomeration) effects. Subsequently, we discuss two different types of cooperative organization in Africa (Section 3) and the importance of strategic resources for entrepreneurial cooperatives (Section 4). In Section 5, some requirements for successful collective action are derived from this literature (commitment and targeting). Section 6 provides an example of FMOs in Ethiopia and, finally, we conclude.

2. Cooperatives and small business in the agricultural sector

In small business and clustering literature, the importance of cooperative economies, or collective external economies, is a well-known issue (Oughton and Whittam 1997). The basic idea is that through cooperation all kinds of fixed costs can be spread over a large number of small actors and, consequently, make these actors competitive in their markets. It was exactly this argument that Audretch and Thurik (2001) used to defend cooperation among SMEs and to urge anti-trust authorities to become more lenient with regard to cooperation (collusion!) among SMEs. They claim that through cooperation more firms would become competitive and, therefore, competition in the market would increase as a result of cooperation among SMEs which would not survive otherwise. The same argument is relevant for smallholders in developing countries. Without cooperation their income generating opportunities are bleak, stimulating many to prefer a future in the towns where a more promising labor market develops (Collier and Dercon 2014; Markelova et al. 2009; Minten et al. 2016). Likewise, successful cooperation explains the survival of many family farms in developed societies that are able to earn a reasonable income through their membership of cooperatives (Cook and Iliopoulos 2000).

Through cooperation it easier to invest in market information and through the created scale the negotiation power of primary producers improves. Similarly, investment in knowledge dissemination becomes more easy and forms of upgrading become feasible. Finally, access to finance can be facilitated if the cooperative plays a role in reducing information asymmetry in the credit relationship with a financial institution. Put differently, cooperatives may facilitate the creation and access to necessary resources and competencies. These resources make it possible to qualify as suppliers in GVCs and may make upgrading initiatives a success. Smallholders cannot access these resources individually, as the fixed and/or transaction costs are too high to recoup the costs on the small turnover of an individual farm (Schmitz 1999; Markelova et al. 2009).

In the same vein, clustering theory stresses the importance of agglomeration effects. Clustering of farmers may improve the labor market, the exchange of knowledge, and the further development of local markets (Kukalis 2010). Cooperative organizations are not a prerequisite to realize cluster effects, but the existence of a cooperative may facilitate the development of these economies.

Although empirical proof for the existence of clustering effects is still rather weak (Kukalis 2010), support for cooperative organizations in the agricultural sector is well documented: 'In Europe, cooperatives in most countries control market shares often exceeding 50% in numerous agri-food categories. In the United States, cooperatives market 32% of the commodities and products produced and processed in the agri-food chain' (Cook and Iliopoulos 2000). Even though these organizations face major challenges as a result of, among others, trade liberalization and the demanding requirements of powerful multinationals, they still play a major role in creating access to credit, inputs, processing activities, and marketing services for farmers. Van Bekkum and van Dijk (1997) specified five historic reasons for cooperatives in the agricultural sector in the European Union: the creation of a countervailing power; improved access to inputs and services and new markets; improved efficiency of the market; better handling of risks; preservation of employment and the raising of income.

All these reasons may apply to agricultural cooperatives in developing countries and confirm the relevance of this organizational form (Collion and Rondot 1998; Markelova et al. 2009). Smallholders in developing countries face markets with major deficiencies or imperfections (Fafchamps 2004). A countervailing power is needed to address traders in local markets characterized by oligopsonistic competition and monopolized input markets for fertilizer, insecticides, and credit (World Bank 2007).

Cooperative action has a long history not only in the developed world but also in developing countries. Remarkably, successful performance is not so evident in Africa. Bernard et al. (2008) did some extensive research on village organizations and came to the conclusion that these organizations are seriously resource constrained. In practice, we see that the important role cooperatives play in agricultural markets in Europe and the U.S. is not visible in sub-Saharan

Africa. Cooperatives are known but market shares of 30–50% as observed elsewhere are not common.

Markelova et al. (2009) argue that cooperatives may fill gaps in imperfect markets and may improve marketing systems. Barham and Chitemi (2009) analyzed collective action initiatives to improve marketing performance in Tanzania and identified characteristics of smallholder farmer groups that improve group marketing performance. Their analysis is based on previous literature (Agrawal 2001; Baland and Platteau 1996; Ostrom 1990) that identified a list of enabling conditions for successful collective action outcomes in natural resource management. Their findings suggest that 'more mature groups with strong internal institutions, functioning group activities, and a good asset base of natural capital are more likely to improve their market situation' (Barham and Chitemi 2009: 53). Although we acknowledge the importance of these aspects for understanding the members' commitment to the cooperative, it is remarkable that for cooperatives that focus on market activities more business-oriented criteria are not specified in this research.

We argue that a better understanding of the disappointing development of entrepreneurial cooperatives in Africa requires more attention for a business perspective and that the discussed generic aspects like trust, group size, and homogeneity of interests call for further detail. We agree that these aspects are keys in understanding the members' willingness to invest and commit to the cooperative. However, other aspects such as targeting strategic resources need further attention when the success of FMOs is analyzed. Before discussing these issues, we address two other aspects that may underline the importance of willingness to invest and commitment: the need for a clear choice between different cooperative models and the importance of the creation of strategic resources.

3. Cooperatives in Africa: FMOs versus community-oriented organizations

Cooperatives are organizations owned and operated by a group of individuals for their mutual benefit. Many of these organizations in developing countries provide club goods and operate within a specific region or village. In more recent literature, cooperatives are also known as village organizations and a distinction is made between community-oriented organizations and market-oriented organizations (Bernard et al. 2008). The former type of organizations focuses on community development and the latter organizations concentrate on income-generating activities for their members.

Membership of community-oriented village organizations is open to all citizens of the community and entry fees are generally low. These are non-profit organizations that may pay a limited return on invested capital. Decisions are based on 'one member – one vote.' They fulfill three functions for their members: provide club goods or services when markets fail, provide local public

services when governments fail, and organize voice in political affairs (Collion and Rondot 1998). In a recent study, Bernard et al. (2008) show that these organizations are present in a majority of villages in Senegal and Burkina Faso, and that a majority of rural households participate in them. However, despite elaborate rules and procedures, and although effective in providing training and information services, these organizations are generally limited in delivering material benefits to their members. The authors conclude that performance is constrained by low professional management capacity and lack of access to resources. However, as long as these organizations are able to provide the club good they can be considered effective and successful as further commercial growth is generally not explicitly targeted.

A crucial difference between market organizations and community organizations is that community organizations focus on access to certain goods and services for the whole community. In many cases, the markets are missing (e.g. access to health services, drinking water, and farm inputs), which implies that there is little competition with private suppliers of these goods/services. This is different for FMOs aiming at improving the competitiveness of member farmers in the output markets. These latter organizations have to be flexible and efficient in order to be able to compete with private traders. Moreover, as more substantial investments may be needed to make these organizations operational, trust among members becomes key and failure may affect the smallholders' income directly and significantly. We note that substantial investment may concern not only the willingness to buy shares of the organization (Sykuta and Cook 2001). It also involves a contribution to the management of cooperative operations, participation in the organization, and commitment to the cooperative decisions made regarding the purchasing and use of inputs and the selling of outputs (Barham and Chitemi 2009; Bernard et al. 2010; Mujawamariya et al. 2013; Wollni and Fischer 2015).

The World Bank (2007) signals a potential conflict between efficiency and equity: FMOs must balance community norms of social inclusiveness and solidarity against business norms of professionalism and competitiveness. Remarkably, this dilemma is not addressed in most of the academic literature (Markelova et al. 2009). Moreover, we have the impression that the issue is neglected in many existing FMOs (see Section 6), as supporting donors and governments generally prefer inclusion: open membership and all-inclusive benefits are the rule even if the cooperative has commercial targets (Tefera et al. forthcoming).

For organizations focusing on community development, inclusiveness and solidarity are the keys. As long as membership fees and required investment are limited, these organizations may perform properly: low investment reduces the need for high fees and low fees avoid selection and reduce free riding. Market-oriented organizations generally require more substantial investments, higher fees, and more commitment. Consequently, professionalism and competitiveness become keys as more money is at stake and the organization has to

compete with private market actors. Put differently, in order to be interesting for their members they have to create a competitive advantage. For these organizations clear targets, commitment of members and, consequently, self-selection of members are key aspects of success.

In some cases open membership may be successful for FMOs. The distinction made by van Bekkum and van Dijk (1997) between two cooperative FMO models is relevant in this respect: the countervailing power cooperative model and the entrepreneurial cooperative model. The first model is viable when collective external economies are 'easily' available and existing private markets face major imperfections. In such an environment open membership may ensure scale as long as small investments are needed and free riding and horizon problems are insignificant. This may concern relatively simple transactions where a group of farmers teams up to bypass a local monopsony and directly supply urban sellers. The second model is more demanding due to competition from private actors. The activities generally concern forward integration into value added activities. More investments are needed and agency problems regarding free riding, tradable shares, open membership, and control, become more important.

In the past the major reason for the establishment of cooperative organizations in the western world was the creation of a countervailing power. However, this argument is becoming less important in the last decades due to problems of control and the need for more flexible and entrepreneurial market organizations (Collier and Dercon 2014; Minten et al. 2016; Sitko and Jayne 2013; van Bekkum and van Dijk 1997: 12). A good example of this development are stricter delivery conditions imposed by buyers or processing industries downstream in the GVC (Donovan and Poole 2014; Van Rijsbergen et al. 2016). In order to address these requirements properly, modern cooperatives supplying GVCs increasingly adopt the entrepreneurial cooperative model. For these organizations clear targets, flexibility in decision-making, commitment, and selection of members are key (Barham and Chitemi 2009; Sykuta and Cook 2001).

The need for scale (Wollni and Fischer 2015) may put pressure on the proper selection of members (Barham and Chitemi 2009). In the literature, this dilemma is known as the 'paradox of group size.' A sufficient scale is an important condition for many FMOs' access to GVCs. Being less severe regarding the selection of members may lead to larger numbers but, as a consequence, makes the internal governance of the FMO more challenging. The trade-off between the two effects will determine the effect on realized turnover. Wincent et al. (2010) show that small groups are generally better at generating funds for innovation than large groups. This is a crucial feature of entrepreneurial FMOs, indicating that larger groups make it more difficult to realize flexibility and govern voluntary contribution.

From the discussion in this section, we conclude that it is important to clearly distinguish community-oriented and market-oriented cooperatives. The targets and the management of these organizations are different. Inclusion is the key for

community cooperatives, while the creation of a competitive advantage is the key for market-oriented organizations. Both types of organizations may follow an open membership strategy if the advantages of economies of scale are easily available. Although markets in sub-Saharan African countries may show a series of deficiencies, this does not mean that markets are missing (Sitko and Jayne 2013). Private actors operate on the markets and cooperative organizations have to compete with these actors. Therefore, successful FMO organizations require commitment from their members. This commitment involves willingness to sell through the organization in order to realize the required scale (Mujawamariya et al. 2013; Wollni and Fischer 2015), willingness to invest in the organization (shares) in order to provide the financial means (Sykuta and Cook 2001), and, finally, willingness to participate in the management of the organization in order to make things work effectively and efficiently (Bernard et al. 2010; Tefera et al. forthcoming). All three commitments are endangered if free riding becomes a significant threat.

4. Creation of strategic resources through FMOs

Market opportunities and participation in GVCs are generally seen as powerful instruments to create income generating opportunities for smallholders (World Bank 2007). In studies on international trade the GVC approach has been used to analyze opportunities for small businesses and farmers from developing countries (Gereffi et al. 2005; Gibbon et al. 2008; Humphrey and Schmitz 2002; Kaplinsky 2000). GVCs are defined as the full range of international production and trading activities by legally independent firms to realize a specific end-product. The approach provides a theoretical framework for better understanding the governance structures between firms involved. Important themes include (1) the amount of value created by each firm in the chain, (2) the vertical governance (coordination and control) in the chain, and (3) the options for firms from developing countries to participate in GVCs.

Requirements for individual smallholders in GVCs are demanding, but cooperative organizations may facilitate this process as investments in resources and competencies can be made more easily if the fixed costs can be recouped on a larger turnover. Cooperatives in Africa may address two different kinds of challenges to create a better position and to appropriate a larger share of the value created:

(1) Through cooperation major market imperfections can be addressed: lack of market power and access to output markets, access to financial means, access to inputs, access to knowledge. This applies in particular to cooperatives that target a countervailing power in deficient markets (World Bank 2007).

(2) Through cooperation strategic resources and new business models can be created that provide farmers a better position in the GVCs. This applies in particular to entrepreneurial cooperatives that compete with other suppliers in GVCs (van Bekkum and van Dijk 1997).

As explained in Section 3, the first challenge can be relatively easily addressed through the exploitation of collective external economies (Schmitz 1999). Access to output markets and provision of inputs may improve significantly through cooperation if the private market faces serious deficiencies. As long as investments are limited the internal management is straightforward and transaction costs can be recouped as a margin on the quantities traded. Experience shows that successful credit distribution proves to be a more demanding challenge for an FMO (Bernard et al. 2010). Although these conditions may apply for some markets we have to acknowledge that on most agricultural markets private traders are effective and compete with FMOs (Sitko and Jayne 2013). Put differently, allegedly major market imperfections may prove less substantial. In many of these situations the second challenge appears to apply.

The development of new business formats, e.g. upgrading, is more demanding as a competitive advantage over private traders has to be created (Teece et al. 1997). A competitive advantage means that a firm is able to outperform its rivals, that is, to earn a higher profit or to appropriate a relatively large share of the created value. As already noted profitability flows to those companies that are best insulated from the profit destroying competitive forces. Barney (1991) scrutinizes this issue and shows that a sustainable competitive advantage is rooted in the control over strategic resources. He defines these resources as assets and capabilities that are valuable, rare, inimitable, and non-substitutable. Resources that fulfill these conditions allow the firm to protect its interest in negotiation processes. For FMOs, these are crucial insights as they have to compete in domestic and international markets. At the same time we recall that if small farmers cooperate, they may be able to create strategic or unique resources. Inter-firm cooperation has received quite some attention in strategic management research, making the argument that an 'atomistic view' of firms prevents one from gaining insights into relational sources of competitiveness and the assets that may arise from joint investments and production. Cooperation enables firms to obtain 'relational rents' that give rise to a difficult to copy 'inter-organizational competitive advantage.' Potential sources of inter-organizational competitive advantage are '(1) relation-specific assets, (2) knowledge-sharing routines, (3) complementary resources/capabilities, and (4) effective governance' (Dyer and Singh 1998: 660).

In the agricultural sector, knowledge-sharing routines are evident in cooperative organizations. Dissemination of information is more easily organized as public extension services are generally only accessible for groups of farmers (Bernard et al. 2010; Markelova et al. 2009). Many cooperatives invest in

complementary assets, e.g. machinery needed for production and certification (Van Rijsbergen et al. 2016). Governance of mutual credit schemes is facilitated by the existence of a cooperative (Markelova et al. 2009). Moreover, cooperatives may make a strategic difference if the access to resources and capabilities they create is difficult to copy (Dyer and Singh 1998). In particular for entrepreneurial cooperatives, this may create the root for durable success, i.e. a sustainable competitive advantage (World Bank 2007).

Interestingly, the GVC literature pays a lot of attention to value creation and requirements that farmers have to fulfill in order to qualify as a supplier in the chain. The unit of analysis is the whole chain. In this GVC literature much less attention is spent on the distribution of value among stakeholders, i.e. the issue of value appropriation. Some explicitly mention the problem and reference is made to Penrose (Gereffi et al. 2005), innovation (Kaplinsky 2000) and upgrading (Humphrey and Schmitz 2002). However, the crucial question how farmers can insulate their farms from destroying competitive forces is not addressed (Barney 1991). What we learn from strategic management is that it is not sufficient for an FMO to qualify for upgrading and to supply a GVC. A complementary condition for success concerns the issue of value appropriation which is rooted in the control of some unique and difficult to copy resources that allow farmers to protect their interests in the negotiation process with buyers downstream in the GVC. Individual smallholders are generally severely resource constrained. Therefore, most of them will not be able to insulate their farms from competitive forces driven by, e.g. powerful traders, processing firms, or upstream retailers. We claim that cooperation can be a powerful instrument to address this weakness.

5. Some key requirements for successful FMOs

The literature on collective action shows that there are several pitfalls. From Ostrom (1990), we derive the importance of group composition (groups may be composed of heterogeneous members with respect to contributions and gains, but should be homogeneous with respect to group goals), group size, and the 'paradox of group size' (the larger the group of farmers that cooperates, the more resources are potentially accumulated, yet, at the same time, the larger the number of members, the more difficult it is to realize and govern voluntary contribution), governance mechanisms (to realize participation in the creation of club goods by a group, opportunistic behavior should be prevented through the regulation of membership and ownership).

Based on the work of Agrawal (2001), Barham and Chitemi (2009) identified a similar list of problems for FMOs in developing countries. In line with this literature, Sykuta and Cook (2001) distinguish five problems that hamper investments in these organizations and may explain why many are less successful than expected in addressing the market opportunities their members are facing: the

free rider problem (gains from cooperative action can be accessed by individuals that did not fully invest in developing the gains), the horizon problem (residual claims that do not extend as far as the economic life of the underlying asset), the portfolio problem (the organization's investment portfolio may not reflect the interests of any given member), the control problem (effective control of the manager by the members), and influence costs (decisions affect the wealth distribution among members). This research was based on experiences of cooperative organizations in the U.S. and, in particular, relevant for new generation cooperatives or entrepreneurial cooperatives for which investments are more substantial and commitment is more critical.

For community-oriented cooperatives many of these problems are easily solved if only minor investments are needed. Even for market-oriented organizations where collective external economies are easily available, limited investments can be recouped on realized turnover: the residual income is simply paid in the form of higher prices to the producer (seller). Regrettably, most advantages are not that easily realized in many African FMOs (Bernard et al. 2008; Sitko and Jayne 2013), implying that a more entrepreneurial organization is required (Collier and Dercon 2014; Minten et al. 2016; Tefera et al. forthcoming). Moreover, the strategic management literature adds to this insight a further requirement: at least some strategic resources have to be created in order to make sure that the cooperative is able to compete with private traders and to appropriate a reasonable share of the value created.

Taking the open structure of many FMOs into account (Bernard et al. 2008, 2010), in particular the free rider problem can be seen as a major challenge. Cook and Iliopoulos (2000) demonstrate that this reduces members' incentives to invest in the organization and that this can be solved through 'a more clearly defined membership policy (closed, or well defined), a secondary market for members' residual claims, patronage and residual claimant status restrictions, and enforceable member pre-commitment mechanisms.' From this and previous discussions, we draw the conclusion that selection based on member commitment to avoid free riding is crucial for success in entrepreneurial cooperatives. Three aspects of member commitment are distinguished: commitment to provide financial resources/collateral, commitment to sell, and commitment to contribute to the management. Targeting is defined as the second criterion. This is related to the issue of homogeneous group goals and further conditioned by insights from strategic management and in particular the requirement to develop strategic or unique resources. Although we acknowledge that these two requirements are not exhaustive, they do cover the key issues mentioned above.

5.1. Commitment to provide financial resources/collateral

The free rider problem may become a serious threat for entrepreneurial cooperatives that require significant investment and commitment. If gains can be

accessed by individuals who did not make the investments, the profitability for investors dilutes (Sykuta and Cook 2001). A solution for this problem can be found in some form of closed membership to make sure that property rights are clear, necessary investments in the organization are made and major free riding problems (moral hazard) are avoided. Shares, dividends, a price premium for members, and agreements on required member commitment are potential instruments to allocate the FMOs' benefits toward the members through ownership-rights.

5.2. Commitment to sell

Efficiency in marketing depends on the commitment of members to sell through the FMO. Side sellings are widespread in the region under study (Bernard et al. 2010). This behavior may be attractive for individual farmers in the short run but undermine the competitiveness of the FMO in the longer run (Mujawamariya et al. 2013; Wollni and Fischer 2015). Commitment to sell facilitates the planning of marketing activities and strengthens the FMOs reputation.

5.3. Commitment to contribute to the management

More members may increase the operating scale, but, concomitantly, make the governance of the cooperative more challenging as governance costs inflate and commitment more easily erodes. The trade-off between the effects will determine the outcome of the 'paradox of group size.' From the literature we conclude that active participation is required and that the entrepreneurial cooperative model is expected to lead to smaller groups and more selection in order to safeguard commitment (Barham and Chitemi 2009; Bernard et al. 2008).

5.4. Targeting

Groups may be composed of heterogeneous members with respect to contributions (investments) but should be homogenous with respect to group goals (Ostrom 1990). The commitment of the members is rooted in the targets and vision of the cooperative. Goal alignment is, therefore, the key for success. Targeting addresses the above-mentioned horizon and portfolio problem (Sykuta and Cook 2001). Targeting defines the purpose of the cooperative and outlines how to create and appropriate values, which is closely related to strategic intent and the creation of strategic resources. Hamel and Prahalad (1989) define strategic intent as ambitious and compelling; a dream that energizes and an intellectual compass for the future. It should convey a sense of stretch, because the current situation provides insufficient perspective. It begins with a goal that exceeds the FMO's present grasp. The strategic intent of the

organization aims to close the gap. Important in this approach is that the goals are clearly specified and that it is feasible for the members to fill the stretch: to create the resources needed to attain the desired goal. From the strategic management literature, we learn that at least some of these resources have to have strategic value to guarantee that the FMO is able to appropriate a reasonable share of the value created.

6. An example: FMOs in Ethiopia[1]

The Government of Ethiopia provides support for the further development of cooperatives (Tefera et al. forthcoming). The current poverty reduction strategy confirms the need to support producer cooperatives as a means of strengthening and empowering smallholders' market participation in the liberalized market environment (FDRE 2005). More recently, Ethiopia adopted an agricultural development strategy, called 'Agricultural Growth Program (AGP),' which gives the highest priority to the formation and strengthening of agricultural cooperatives.

In one of the Ethiopian regions, Oromia, NGOs promote farmers' market organizations and their competitiveness in agricultural commodity value chains, for at least the last 10 years. The main activities concern food crops: the design and provision of tailor made capacity building, training, coaching and mentoring of FMOs, supporting the formation and strengthening of unions, linking farmers' organizations with chain actors and chain supporters, introduction of new high-value crops, supporting locally initiated rural service providers and capacity building of pro-poor, and gender-sensitive agro-business. The NGOs involved in the study support about 140 FMOs in Oromia. We randomly selected 16 FMOs operating in the different Woredas in this region and interviewed 550 members (Stichting Gezamelijke Evaluaties 2015). It is beyond the scope of this paper to provide a detailed overview of these data. However, we use some of the data as an input for the discussion in this section which aims at showing that the crucial requirements for successful FMOs are not properly addressed to explain the disappointing performance of the FMOs under study.

FMOs are located in Kebeles, the lowest administrative level in Ethiopia, which encompasses three to four villages, with an average of 1000 rural households (Bernard et al. 2010; Francesconi and Heerink 2010). Due to regulations FMOs are unable to grow beyond the boundaries of their Kebele and within a Kebele it is not allowed to have more than one FMO with the same mandate. FMOs are organized and controlled by the members. As FMOs are relatively small in scale (about 100 members per FMO) they are managed on a voluntary basis by the members. Although formal rules do not impose criteria for selection or open

[1]We take these FMOs as an example as they are quite representative for the efforts made to improve the performance of cooperatives in Ethiopia We evaluated the impact of the NGO support for the period 2012–2014 (Stichting Gezamelijke Evaluaties 2015).

membership, at the local-level government representatives strongly favor open membership. Likewise, the NGOs involved encourage inclusion which also limits the instruments that can be used for selection. We characterize the FMOs by the following features:

6.1. Commitment to provide financial resources/collateral

As a result of the inclusive development strategy, farmers are asked to invest only a small amount of effort if they want to become a member, as required ex-ante effort may become a selection mechanism. Each member is required to pay a membership fee (about 100 Birr or 4.7 USD) at their registration. This revenue, in combination with the revenue from trading activities, is too low to finance the FMO operations. Access to loans is very difficult and NGOs are by law forbidden to provide credit to the FMOs. This situation seriously restricts FMO operations, i.e. trading activities. FMOs argue that they simply can't buy sufficient quantities to generate a substantial profit and, consequently, members do not receive what should be the main financial benefit of an FMO membership: dividend or better prices. So far, none of the investigated FMOs has found a solution for this.

6.2. Commitment to sell

Our survey results show that less than 50% of the members do sell to the FMO and even if they sell they have important side sellings to the private market. Many explain this by the fact that the cooperative was not buying when they needed the money (self-reported argument). We doubt whether this is the only argument, as dedicated members of the FMO can be expected to do their utmost to sell through the FMO. Similarly, agile FMOs are expected to be able to arrange financial constraints and to develop contracts with buyers in the wholesale market, in particular in Ethiopia where the economy is growing quickly and urban food markets are developing fast (Minten et al. 2016).

6.3. Commitment to participate in the management

The leadership is not based on capability but more on social or local status. The intention is to select FMO committee members for a term of several years. However, according to NGO staff, most of the FMOs have multiple leaders per year as local 'issues' may continuously change FMO leadership. It is especially this turnover that creates problems, since the knowledge on leading an FMO; the knowledge gained by NGO training; the networks and the market knowledge are often lost quickly. The financial control is weak. Although a yearly audit should take place, the lack of auditing officials results in audits taking place only every three years. This leaves room for the FMO officials to manipulate

financial reports. The interviews revealed that this suspicion was shared by several stakeholders.

The FMOs are managed by the members on a voluntary basis. FMO activities are not always the first priority of the managers as they also have to cultivate their plots and manage their farms. This creates problems in certain periods, like the harvesting or sowing season. At these times, farmers require the FMO most, since they either want to buy (fertilizer; seeds) or sell (wheat; barley; maize; teff). However, often there is nobody present at the FMO office to perform these activities leaving the members with no other option than to wait or to turn to the FMOs main competitor: the private trader.

6.4. Targeting

We observe that in particular the more entrepreneurial activities hardly develop. Many members see FMOs mainly as the preferred supplier of inputs. If they sell to the FMOs they sell through their Unions, a fixed business model focusing on the benefits rooted in economies of scale, while alternative business models and local initiatives are scarce. At FMO level, we did not meet representatives or members with a clear vision of future developments and FMO targets.

So far, most FMOs cover only 10% of the households in their Kebele (Bernard et al. 2010). To be more influential, they deem a higher participation rate necessary. All applicants are allowed to become a FMO member, even if it is doubtful whether they are committed to the organization. Consequently, these FMOs are characterized by a small membership fee, no obligation to sell or to participate in meetings or other activities of the cooperative. Membership has no consequences for the farming system (choice of crops, use of inputs). Moreover, the marketing services of the FMOs are open for non-members (sale of crops, purchase of inputs). Basically, this means that FMO membership is open to all the villagers that see a benefit in joining the cooperative.

If the cooperative aims at the creation of a countervailing power the problems related to weak selection and unclear targets can be accommodated if minor investments are needed. As long as the realized turnover allows to recoup the costs the FMOs will survive. It is observed that quite a number of FMOs survive even without any turnover (40% of the FMOs in the study of Bernard et al. 2010). The downside of this situation is that it is difficult to see how the countervailing power of these FMOs can be credible if no transactions are taking place. Moreover, if the FMOs market share is small, it is questionable whether the FMOs are able to compete with private traders and whether the supposed market deficiencies are indeed that important. The markets do face imperfections but it is well possible that private traders are better capable of dealing with these circumstances than FMOs. It is also possible that private traders simply offer higher prices to attract supply in villages where FMOs are operating (Bernard et al. 2010). This indicates that traders apply a limit pricing strategy to

accommodate the entry of an FMO. Local market prices may increase for farmers, which can be interpreted as a positive impact of FMOs. However, the problem is that, although farmers get a better price, the FMOs do not evolve in strong competitors for private traders as necessary resources and capabilities are not improving. Moreover, if turnover within FMOs remains small the sustainability of the cooperative organization becomes doubtful (Mujawamariya et al. 2013; Wollni and Fischer 2015).

We conclude that existing FMOs behave in line with the countervailing power model, but do not become a sustainable competitor in the market as this requires an entrepreneurial strategy. Activities of existing FMOs are based on the expectation that markets show serious deficiencies that can be solved easily without major commitment of members. The results so far indicate that the market only allows room for resilient entrepreneurial FMOs that are able to compete with private traders. It appears that competitive threats from FMOs that only target a countervailing power are easily countered by incumbents through limit pricing. Put differently, the existing deficiencies are more easily addressed by the incumbents than the FMOs.

If an entrepreneurial cooperative is targeted it is clear that practice in Ethiopia shows major weaknesses concerning targeting and commitment. All these weaknesses explain why it is difficult to observe performing organizations in Oromia. Unclear targets, weak selection, weak commitment will make it impossible to realize the needed investments. If targets are known, needed investments can be identified and members can be selected on the basis of their willingness to invest and to commit. Finally, property rights have to specify how the benefits of the cooperative are distributed over the stakeholders. It is clear that these steps are not followed by the FMOs under study and, therefore, it is not a surprise that they do not undertake entrepreneurial activities.

7. Conclusion: some generic requirements for successful FMOs

In this paper, we discuss the importance of making a distinction between different cooperative organizations. First of all, a clear distinction between community- and market-oriented cooperatives is crucial. Inclusion and participation may drive the first cooperative if required investments per member are limited. In case of FMOs and in particular for entrepreneurial cooperatives, selection becomes important. Commitment and targeting are needed to create a competitive organization that controls strategic resources and competes with private actors in the market. Practice shows that this is difficult to realize as many FMOs are based on open membership and low membership fees.

We observe that donors and governments are a major player in this process as a provider of all kinds of support. Governments may use the cooperative structure in their rural development policy and are keen to establish organizations that strive for a large member-base. Donors are driven by criteria regarding

poverty reduction and focus on the rural poor. The supported community-oriented cooperatives may perform well in creating access to local club goods like drinking water, health services, and agricultural inputs for all. Many of these organizations are also active as FMOs. For FMOs competitiveness becomes the key as competition from private actors on the local market has to be addressed. We observe that many of these organizations lack access to sufficient financial means. If external donors (NGOs or government policies) are willing to finance the needed investments this problem may be accommodated for some time. However, if the commitment of external partners is limited, or temporary, clear choices have to be made in order to encourage members to invest in their organization and to avoid serious resource constraints in the longer run.

The situation observed in the 16 FMOs is very much in line with the conclusions drawn from a large study of cooperatives for staple crop marketing in Ethiopia (Bernard et al. 2010): management is not transparent (lack of managerial resources); deficient commitment as free riding is too attractive; selection is lacking as inclusion is key; no willingness to invest as benefits are diluted and free riding is a more attractive alternative. We add a new perspective on understanding why these cooperatives do not develop into thriving organizations. Not only problems related to collective action and commitment explain the results. We argue that the lack of a strategic approach and proper targeting are crucial deficiencies that explain why the FMOs do not develop into entrepreneurial organizations.

We conclude that the needed entrepreneurial initiatives to create new business models and further growth are missing. A stalemate situation occurs. This is a missed opportunity for smallholders to organize themselves in competitive entities that successfully compete with other private organizations and to appropriate a larger share of the value created. Finally, we note that not only policy makers or FMOs fail to address the strategic elements. Also researchers have to integrate these issues and a plea is made for much more empirical research in line with the arguments of Bruton et al. (2013) and McMullen (2010).

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No potential conflict of interest was reported by the authors.

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